EXPERT COMMISSION ON PENSIONS

Reviewing Ontario's Pension System:
What are the Issues?

A Discussion Paper for Interested Ontarians

February 2007

Ontario

Expert Commission on Pensions

Commission d'experts en régimes de retraite

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Contents

What Is This Discussion Paper?

The Commission and its assignment

In November 2006, the Honourable Greg Sorbara, Minister of Finance, appointed an Expert Commission "to examine the legislation that governs the funding of defined benefit pension plans in Ontario, the rules relating to pension deficits and surpluses and other issues relating to the security, viability and sustainability of the pension system in Ontario." The Commissioner, Professor Harry Arthurs, is advised by a panel of four experts representing different professional disciplines and perspectives on the pension system. Their backgrounds are described in the appendix to this discussion paper and may also be found on the Commission website www.pensionreview.on.ca.

The detailed terms of reference — also posted on the website — not only define a number of important issues concerning defined pensions plans. They also instruct the Commission to have regard to a number of social and economic developments which affect the pension system. Finally, they identify the principles which are to guide the Commission's work:

- the importance of maintaining and encouraging the system of defined benefit pension plans in Ontario;
- the importance of maintaining the affordability of defined benefit pension plans for both members and sponsors;
- the importance of pension plans in supporting a competitive economy;
- the need to safeguard the security of pension benefits;
- the need to balance the rights and obligations of employers, plan members and pensioners; and
- the impact of demographics and the changing nature of the workforce on the provision of employment pensions.

What this discussion paper does and does not do

The purpose of this paper is to invite interested and knowledgeable parties, and Ontarians in general, to join in a discussion of the issues that the Commission has been asked to review. Although many of the issues are complex and involve technical information and expertise, this paper attempts to set them out in relatively simple language to enable ordinary citizens — as well as experts and stakeholders — to participate.

A few preliminary remarks about this paper may help readers of all kinds to understand its intent and to respond to its challenges. Much of this paper addresses the issues listed in the Commission's detailed mandate. These are the issues concerning which the Commission must and will make recommendations. A second set of issues has to do with the social and economic environment in which pension plans operate, and with the principles which the Commission has been asked to follow. The Commission will no doubt have to address those matters in its deliberations and its report, but more by way of establishing a context for its analysis than with a view to making concrete recommendations about them. A third group of issues is raised for discussion not because they fall directly within the Commission's mandate, but because they are known to be of great concern to people who think about pension policy and work with pension plans. Given that these issues are almost certain to be raised in submissions to the Commission, it has tried to frame them in such a way that discussion about them will in the end assist the Commission in investigating the concerns at the core of its mandate, as set out above.

However, this discussion paper is neither definitive nor exhaustive. Consequently, mention of a particular issue in this paper by no means signals that the Commission will be dealing with it in its final report, nor does failure to mention an issue imply that it will be ignored by the Commission. Much will change as the Commission hears from Ontarians, as its research program sheds new light on the issues and as it gains a better understanding of the subtle and intricate connections amongst the many parts of the pension system.

Discussions with experts, stakeholders and the public

The Commission intends to launch a program of research, to consult directly with major stakeholder and professional organizations, and to hold public hearings across the province in the fall of 2007. It will soon announce a timetable for its research program, consultations and public hearings, and for the submission of formal briefs. The Commission welcomes queries and communications concerning its work, by mail, e-mail or online, via its website.

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The Background

Pension plans and income security for older Ontarians: A brief introduction

All Ontarians are eligible to participate in the Canada Pension Plan (CPP) and, depending on their income, to receive Old Age Security (OAS) benefits as well. In addition, many Ontarians have accumulated savings that will provide them with an income when they retire from the workforce. In some cases, these savings take the form of tax-sheltered registered retirement savings plans (RRSPs); in other cases, they are held in the form of deferred annuities, or bonds and equities, which will provide them with retirement income. Finally, Ontario seniors may be eligible for government financial assistance in the form of income supplements and subsidized drugs, housing and services. While all of these arrangements provide important elements of income security for older Ontarians, none of them falls directly within the terms of reference of this Commission.

The Commission's primary focus is on defined benefit pension plans provided to employees at their workplaces. Defined benefit plans provide pensioners with a retirement income that is calculated either as a percentage of their average annual earnings while employed, or as a dollar amount per year of service. Defined benefit pensions are fixed, rather than tied to fluctuations in the sponsor's business fortunes or to investment returns experienced by the plan. Accordingly, the risks associated with low investment income, for example, are borne by the sponsor(s) of the plan.

Some employers sponsor defined contribution pension plans, which provide retired members with a lump sum at retirement, comprising the total contributions, and investment returns on those contributions, that have accumulated over the years preceding retirement. This sum can be used to create annual income for the retiree either by purchasing an annuity or by establishing a retirement income fund. Consequently, the amount of the employee's pension depends on several factors, especially the amount of the lump sum available at retirement and the costs of annuities at the time the annuity is purchased. In this respect, defined contribution plans differ importantly from defined benefit plans.

Particulars of occupational pension plans vary from workplace to workplace. While employers are not required by law to establish pension plans or to establish them at any particular level, many find that offering an attractive pension plan enables them to recruit and retain employees. In addition, unions representing their workers may persuade employers to establish and maintain pension plans as part of an overall agreement concerning wages and working conditions. Indeed, in some industries, unions either manage pension plans themselves or do so in partnership with individual employers or groups of employers.

The health of Ontario's system of occupational pensions is of interest not just to employers who fund them, to retirees who receive them or to workers who expect to do so, but to all the people of Ontario. The extent of coverage provided under the current pension system, and especially its accessibility to workers, involves issues of social protection and collective representation. The cost of the system to employers, employees and government (through the tax system and in the event of plan failures) is a matter affecting economic policy. So too are the effects of pension plans on the productivity of Ontario workers, and the attachments of workers to particular employers and to the workplace in general. Ultimately, pension plans affect the purchasing power of Ontario consumers and the economic vigour of our communities. And the accumulation and investment of the huge assets of occupational pension plans is a significant factor in determining the strength of financial markets and the availability of investment capital.

Recent developments affecting the Ontario system of occupational pensions

The Ontario *Pensions Benefits Act* (PBA) is the principal statute governing the province's pension system, though the system is also affected by the federal *Income Tax Act*, other federal and provincial legislation, and the general law of contracts and trusts. The PBA was originally enacted in 1965 and amended, in 1988. It has not been systematically reviewed since that time. Over the years, however, many changes have occurred with the potential to affect occupational pension plans.

The introduction of new technologies, new patterns of global competition, new strategies of production and distribution and new corporate structures has reconfigured Ontario's economy. In the process, the environment within which plan sponsors evaluate the attractiveness of occupational pension plans has changed. Those in rising sectors of the economy may feel they must offer generous pensions in order to attract and retain highly skilled workers in a tightening labour market. Those in more difficult circumstances may feel reluctant to establish new plans, or even maintain existing plans in their existing format.

The working life of many Ontario workers has changed too. Most still work in one full-time permanent paid job; however, self-employment and what labour economists refer to as "precarious" work — agency, contract, temporary and part-time work — have been on the rise. Further complicating the situation is the fact that in the future more workers are likely to be absent without pay from their workplaces for extended periods of educational, maternity, parental or family leave. The pension system will have increasingly to deal with workers who move in and out of pensionable employment and, some predict, from one pensionable job to another.

The face of Canadian workers has changed as well. Workplaces are becoming more populated by highly trained workers, women and recent immigrants, all of whom — for quite different reasons — are likely to have to fund their pension entitlements over fewer years than workers did in the recent past. Moreover, our population is aging, and the proportion of retirees under occupational pension plans has increased relative to active wage earners — in some cases, quite dramatically. This points to the need to develop appropriate funding models for occupational pension plans with declining new enrolment. On the other hand, with an end to mandatory retirement, some people may be inclined to remain in the workforce longer than they used to, and some may work part time rather than full time as they ease into retirement. The pension system will have to adjust to more varied patterns of contribution and more flexible and ambiguous patterns of retirement.

Finally, defined benefit plans are often (but not always) associated with unionized workplaces. Changes in union density across the economy may affect the overall coverage of defined benefit plans. All of these developments, which have accelerated since the PBA was first enacted, may require that workers, unions, employers, plan administrators, regulators and policy makers revisit their previous assumptions about various aspects of the pension system.

The financial context has changed somewhat. Following two decades during which many plans experienced periodic surpluses, in the early 2000s, many began to experience a serious deterioration in their financial position. The causes of this shift have been variously diagnosed: changing business conditions; volatility in the stock market; a decline in long-term interest rates; contribution holidays by employers; and others. The consequences may vary from time to time and from plan to plan: most plans will successfully adjust on an ongoing basis to real or impending surpluses or shortfalls, but others may fall into difficulties, especially when sponsoring employers are confronting business difficulties or insolvency, and are thereby unwilling or unable to make contributions at the level necessary to maintain the plan in financial health. However, there is one constant: if financial shortfalls are allowed to persist, and if plans do fail, the effects will be experienced most intensely by the pensioners and prospective pensioners who will receive pensions far less than those they bargained for and need to pass their retirement years in dignity.

Further, the realignment of government functions and reductions in taxation and government expenditure during the politically volatile decade of the 1990s, the restructuring of the economy following the advent of NAFTA and successive waves of corporate mergers and acquisitions significantly altered the pension landscape, as long-established plans have had to be reconfigured, merged or, in some cases, wound up. Such abrupt disjunctures in the life of a plan may precipitate disputes or

even lawsuits. Workers tend to view plan assets as part of the total compensation that they have earned, and to which they alone are entitled. Employers, by contrast, tend to describe this view as resting on an "asymmetry"; having borne the risks associated with defined benefit plans, they argue, employers ought to have access to any rewards that may become available. To be sure, conflict is not inevitable; sensible people can resolve their differences in advance or after the fact. But the risk of conflict is perhaps greater now than it was when the PBA was last amended.

Pension funds that used to invest almost exclusively in government bonds now own shares in public and private equities, real estate and other more volatile or illiquid assets. This change may have enhanced the risk of a mismatch between plan assets and liabilities that, perhaps, contributed to the swing from surplus to deficit conditions in many plans after 2000. As a result, actuarial assumptions concerning pension funding and the accounting rules for financial reporting also changed, with both emphasizing short-term market conditions. This is a change from traditional practices, which treated pensions over a longer time horizon. Indeed, pension accounting rules may well change again in 2007, possibly to put pension deficits and surpluses directly on the corporate balance sheet, leading to the corporate finances being more directly and immediately impacted by volatility in surpluses and deficits.

These recent changes in the asset mix of pension funds, in their increased volatility, in their actuarial valuation and in accounting practices, have all triggered demands for sponsoring employers to increase contributions to their pension plans in order to avoid or retire deficits. Arguably, these increased contribution levels may have two effects. First, they may persuade employers to postpone or resist the introduction of additional benefits. Second, employers may increasingly come to perceive pensions as a major cost centre, to focus on the difficulties of managing the volatility of pension costs, and to seek ways to mitigate their pension risks, all to the potential detriment of defined benefit plans and the workers who depend on them.

Institutional architecture has changed, as the pension system has adapted to the new socio-economic and financial environment. Those who design and administer plans, and who write the rules by which they are governed, know — or ought to know — more than they used to about the governance of plans; about their membership profiles; about their size and sophistication; about their investment and benefit policies; and about their capacity to deal with or survive difficulties. To cite but one example, most major Ontario public-sector plans are jointly sponsored; employees and employers share the costs and risks of funding these plans; and both share responsibility for administration and investment strategies. Changing institutional arrangements, and our additional knowledge about governance and plan management, will hopefully enable us both to more

accurately assess their strengths and weaknesses, and to suggest innovative responses to the difficulties they face.

The legal and regulatory context has changed and continues to do so. Protracted and expensive civil lawsuits, sometimes in the context of insolvency proceedings, have produced important, but occasionally unexpected, conclusions about the legal rules governing funding deficiencies, surpluses and other matters. The need for such litigation may be prima facie evidence that the existing legal regime requires further clarification or revision. The pension regulator, the Financial Services Commission of Ontario (FSCO) may not possess all of the powers and resources it needs to keep the system in good repair. Some suggest that FSCO's powers should be extended and its staff reinforced; others contend that FSCO should play a different or lesser role in pension regulation, or that the functions of its adjudicative body, the Financial Services Tribunal (FST) might be transferred to the regular courts. And of course, jurisdictions across Canada have been experimenting with pension regulation over the 20 years since the PBA was last amended; perhaps Ontario can learn from their experience. Indeed, some contend that harmonization of pension regulation would facilitate plan administration — a view that must be balanced against the natural desire of governments to establish their own policies.

Finally, the policy environment for occupational pension plans has changed. The appropriate balance between collective and individual responsibility for social risks has been hotly debated, as has our financial capacity to pay the taxes or levies required to sustain existing or expanded social security regimes. Depending on the outcome of these debates, workers may have to rely increasingly on occupational pension plans and other forms of private savings. These and other developments have generated a range of concerns about the role that defined benefit plans ought to play within the overall system of income security for Canadians.

To sum up: for various reasons the percentage of workers covered by occupational plans has declined since 1988; the balance between defined contribution and defined benefit plans has shifted somewhat in the direction of the former; the employment model that underpins occupational pension plans has changed somewhat; the economic, legal, financial and policy contexts of the pension system have developed over the past 20 years; and the impact of defined benefit pension funds on the economy has increased as they have matured and their assets have grown. For all of these and other reasons, the present review of Ontario's pension legislation is indeed timely.

Some general questions raised by these developments

The developments outlined above give rise to a series of general questions:

1.1 To what extent do occupational pension plans — especially defined benefit plans — contribute to the overall provision of income security for Ontario's older workers?

1.2 To what extent do these plans presently meet the needs and expectations of their members and sponsors?

1.3 How well have these plans been managed in recent years, and how might their management be improved?

1.4 Why has coverage by defined benefit plans decreased? Why are few, if any, new defined benefit plans being established?

1.5 In light of recent court decisions, are appropriate legal rules in place to protect the interests of present and prospective pensioners, and of employers who sponsor plans?

1.6 Are appropriate oversight mechanisms available to ensure compliance with the legal rules?

1.7 Should different kinds of workers, employers and plans be subject to different regimes of regulation?

1.8 How much importance should be attached to the harmonization with the law of other Canadian jurisdictions?

1.9 What are the overall effects of the present system of occupational pension plans on Ontario's social policies and economy?

These are not simple questions. Understanding them may require sophisticated and specialized knowledge of actuarial science, law, social policy and economics. Deciding on answers to them may affect not only Ontario's present employers, workers, taxpayers and regulators, but also people 30, 40 or 50 years from now, some of whom may well be located in other jurisdictions. For those answers to make a positive difference, Ontarians will likely have to make some tough choices not just about private pension plans, but also about public policies and the deployment of public resources. For all of these reasons, the Commission intends to conduct extensive research, become informed about developments in other jurisdictions, consult carefully with the stakeholders and seek the opinions of those who are most affected by the health of our pension system — which is to say, all of us. We expect this to be a most productive conversation.

Major Issues Confronting the Commission:

A Guide for Those Who Wish to Join the Conversation

The issues identified in the following section of this paper will loom large in that conversation. We hope that this brief introduction to them will provide Ontarians with some indication of the major issues at stake in the Commission's review. We also hope that it will give some guidance to individuals or organizations that may wish to make submissions to the Commission.

The effects of a changing social and economic environment

The Commission will be conducting research on the actual effects on pension plans and policies of changes in Ontario's social and economic environment, whether these have actually occurred or are reasonably foreseeable. However, it would be particularly helpful to the Commission if briefs and submissions began with an assessment of the effects of these actual or anticipated changes. To the extent possible, such assessments ought to be supported by reference to expert studies — whether previously published or undertaken specifically for this purpose. How have long-term changes in the structure of Ontario's economy, in its labour market and social welfare policies, and in patterns of employment, unionization and compensation affected occupational pension plans?

2.1 How have long-term changes in the structure of Ontario's economy, in its labour market and social welfare policies, and in patterns of employment, unionization and compensation affected occupational pension plans?

2.2 How will longer life expectancies and the end of mandatory retirement affect such plans?

2.3 Is the ratio of retirees to active members of occupational pension plans changing, and, if so, why? What are the effects of such changes on these plans?

2.4 How have recent fluctuations in investment returns and long-term interest rates affected defined benefit plans in particular?

2.5 Are such fluctuations likely to accelerate or decelerate in the future? Can new tendencies be identified that might affect these plans positively or negatively?

2.6 How might changes in the viability, coverage, cost and funded status of occupational pension plans affect the prosperity, security and well-being of Ontario workers and pensioners?

2.7 What has been the impact of inflation on pensioners and pension plans? How common is the indexation of pension benefits?

2.8 How does the health of occupational pension plans affect the robustness of the Ontario economy and the success of Ontario businesses? How might their

health affect different workplace constituencies such as public and private sector employers, large and small enterprises and unionized and non-unionized workforces with different demographic profiles located in various work settings?

2.9 Are changes in the structure and governance of occupational pension plans likely to affect their administration and financial well-being, and if so, how?

Innovation and constraints in pension policy-making

If, as seems likely, occupational pension plans — especially defined benefit plans — will be experiencing a rather lengthy period of adjustment to these new conditions, it is important to consider what contribution they will be able to make in the years ahead to the overall objective of enhancing income security for older Ontarians. This will necessarily involve some reflection on the other approaches to income security which are likely to exist alongside occupational pension plans as we know them today. Some of these other strategies may originate at the provincial level, others at the federal level, still others in the form of creative experiments by sponsors with new types of pension plans.

Of course, the possibilities for innovation are not unlimited. The distribution of constitutional responsibilities may constrain or complicate new initiatives. Pension policies must be coordinated with those originating in other domains, such as social welfare, labour policy and economic development. Costs and risks must always be taken into account, whether they are born by employers, workers or taxpayers. And creative, non-statutory experiments must take place within boundaries fixed by law.

This last point is of special interest. Some commentators suggest that the relatively small size of many single-employer pension plans is a major source of difficulty. Their unit costs of administration are too high; they lack the expertise (and often the leverage) to initiate sophisticated investment strategies; and these difficulties in turn may discourage small and medium-sized enterprises from adopting pension plans in the first place. One solution to this problem might be to encourage greater pooling of pension funding, administration and expertise, perhaps by enabling single-employer plans to be administered on a sectoral, multi-employer and/or cooperative basis. In fact, multi-employer and jointly sponsored pension plans already exist in Ontario and somewhat similar large-scale plans are found in other jurisdictions. The attractions and risks of multi-employer and other non-standard plans, and the mechanisms needed to oversee their operation, are issues which require careful consideration. However, given the increased complexity and volatility of developments in this field, innovative pension plan designs should in principle be encouraged rather than discouraged.

3.1 What role are occupational pension plans, especially defined benefit plans, likely to play in the array of strategies which will provide economic security for future generations of older Ontarians?

3.2 Will these strategies, in combination, provide all retired Ontarians with a measure of equity and security?

3.3 What can be done to strengthen the role of occupational pension plans in the short term? In the longer term?

3.4 What degree of latitude or encouragement should Ontario pension law and policy provide for plans other than conventional single-employer plans? Should it actively encourage the formation of larger, more sophisticated sectoral, multi-employer, jointly sponsored or cooperative plans? Should other experimental designs be accommodated under the *Pension Benefits Act* and, if so, subject to what conditions and controls?

The role, risks and attractions of defined benefit pension plans

The Commission's mandate focuses on defined benefit pension plans. Defined benefit plans are attractive for plan members because they insulate them from interest rate changes or changes in asset values and ensure that their retirement income will bear some relationship to the income they earned while still working. Moreover, these plans — which cover a higher proportion of workers in unionized than non-unionized workplaces and in the public sector than the private sector — sometimes provide for other retirement-related benefits and, notably, for indexation (protection against inflation).

Indexation is not required by law in Ontario. While about 17 per cent of all Ontario defined benefit pensioners receive full protection under the terms of their pension plan, about 35 per cent receive partial protection, and the rest depend on ad-hoc, discretionary and partial adjustments, which are most likely to occur when the plan is in surplus. Inflation protection under defined benefit plans is obviously a significant issue for pensioners and employers alike.

On the other hand, the potential volatility of costs under defined benefit plans presents risks for sponsoring employers that are often perceived to be greater than those associated with defined contribution plans; their administration is more complex; and they are subject to closer oversight. Conversely, the contributions made by employers to defined contribution plans may be lower than those to defined benefit plans, depending on financial market conditions and on the rate of contributions.

All of these considerations might conceivably motivate Ontario employers to shift from defined benefit to defined contribution plans, following apparent trends in

this direction in the United Kingdom and the United States. However, so far at least, any such movement has been more gradual than elsewhere. One explanation may be that a number of jointly sponsored pension plans exist in Ontario, in which funding risks and surpluses are shared between employers and employees, and the plan is jointly governed by an equal number of representatives of employers and employees. Most of Ontario's largest public-sector plans, and some elsewhere, adhere to this model of joint funding and joint governance. Conceivably, this approach, or some variant of it, might be regarded as an attractive option by some employers who are considering whether to initiate or retain defined benefit plans.

4.1 What are the unique attractions of defined benefit plans? What special problems are associated with them?

4.2 Will fluctuations in unionization rates and in levels of public-sector employment affect the extent of their coverage and their financial viability in general and in different sectors?

4.3 What is the effect of employer business strategies on the form of pension provision? What is the impact of privatization, mergers, acquisitions and bankruptcies on defined benefit plans?

4.4 To what extent should public policy promote and protect defined benefit plans because of their attractions? To what extent can changes in public policy and legislation reduce or eliminate the perceived shortcomings of defined benefit DB plans to encourage their wider adoption?

4.5 Should indexation of defined benefit plans to offset inflation be left to the discretion of the plan sponsor, subject to collective bargaining in the case of unionized workplaces?

4.6 To what extent should public policy encourage experiments with new varieties of occupational pension plans (such as cash balance plans that are widely used in other countries) or with alternative types of income security plans designed to deliver retirement benefits to workers comparable to those provided by conventional defined benefit plans?

4.7 Should Ontario compile and publish materials that might enable members and sponsors to make more informed choices among different types of plan design and strategy?

4.8 Would joint administration of defined benefit plans, or other changes in their structure and governance, make them more attractive to employers or less?

Underfunding and overfunding

The PBA lays down rules governing the funding of pension plans. These rules are intended to ensure that the plan can afford to pay benefits at the promised level to present and future pensioners. However, since those benefits will be paid many years from now, whether funds are likely to be sufficient for the purpose depends upon actuarial estimates. These estimates, in turn, are used to determine the level of contributions required to keep the fund solvent.

However, making estimates is difficult. Because the value of plan assets fluctuates constantly as a result of changes in investment and market returns, and because the present value of the benefits to be paid in the distant future depends on so many contingencies, pension plans often are — or appear to be — either underfunded (to have a "deficiency") or overfunded (to be "in surplus"). What to do about a deficiency, how surpluses are used, and the impact of either condition on the rights of workers and plan sponsors, have all been controversial issues.

Moreover, given that pension funds may move between apparent deficiency and apparent surplus within a reasonably brief period, there may be good reasons to consider the two conditions in relation to each other. For example, one common method of dealing with a surplus is to allow the employer to take a "contribution holiday"; that is, to stop making contributions until the surplus is eliminated by a decline in the value of plan assets or by the growth of additional liabilities. However, some observers believe that contribution holidays leave pension plans exposed to unexpected deficiencies if they subsequently experience declining revenues or asset values. On the other hand, some contend that since employers must make good deficiencies suffered in bad times, it is only fair that they should be able to recoup their fortunes if a fund produces a surplus in good times.

Clearly, the Commission will have to consider whether existing rules for addressing overfunding and underfunding are appropriate or whether, as other jurisdictions have done, Ontario ought to preclude or regulate employer contribution holidays and access to plan surpluses, and to make better arrangements to enable or require employers to deal with plan deficiencies. Because the *Income Tax Act* contains provisions relating to contribution holidays and to maximum levels of contribution, it may be that the federal government will have to be involved in any discussion of such changes.

Further, it is important to ask whether employers experiencing different levels of business success or distress, plans exhibiting different investment profiles and plans with different levels of obligation to their members all ought to be subject to identical forms of regulation on the grounds that "one size fits all"?

5.1 Are existing definitions of plan "solvency" realistic?

5.2 Are the consequences of over or underfunding for employers, workers and pensioners fair, clearly stipulated, well understood and appropriately enforced?

5.3 Is there a necessary connection between underfunding and overfunding? If so, what does that connection mean for how the rules should address both situations?

5.4 Should the pension regulator have wider powers to address funding concerns? If so, should these be discretionary powers?

5.5 Should different rules apply to different kinds of plans and different kinds of employers? If so, what distinctions would be appropriate and why?

5.6 Should relief be provided against present solvency funding requirements, and if so, to which types of pension plans, in which sectors, and under what conditions?

5.7 Should the sponsoring employer's financial strength be taken into account? And if so, to what extent and by what means?

5.8 What types of measures might be made available to employers to enable them to deal with funding deficiencies that seem likely to be short term?

Ensuring solvency in a volatile economy

One way that sponsors might mitigate the risk to plan solvency caused by volatile money markets and business conditions is to put extra funds into their plan when business is good and investment returns are high, in order to buffer the plan against future downturns. However, several considerations militate against such an approach. First, enterprises may prefer to use available capital for business purposes rather than depositing it in their pension plan. Second, the amount that can be deposited is limited by provisions of the *Income Tax Act*. Third, if surpluses accumulate in the plan over time, whether through special "rainy day" payments or otherwise, in some plans they may be locked in or subject to sharing with the union or plan members. The existence of a surplus may, of course, justify the employer taking a "contribution holiday" (unless the plan or the collective agreement provide otherwise) but this approach is also subject to practical and, sometimes, legal limitations.

Quite apart from the issue of how to deal with surpluses, it seems possible that plan sponsors might be tempted to try other responses to periodic threats to plan solvency. Specifically, they may decide to adopt a more aggressive investment strategy in order to maximize returns and reduce deficits faster, but perhaps at the price of higher risk for the employer and the members. Alternatively, they might move into more conservative asset classes to diminish the effects of future cost

volatility, but perhaps at the price of not being able to afford future pension improvements.

6.1 Should Ontario urge the federal government to amend the *Income Tax Act* to allow plan sponsors to make extra contributions to the plan from time to time to keep it solvent over the long term?

6.2 Should plan sponsors be given greater latitude to increase contributions or reduce benefits under carefully specified conditions?

6.3 Should public policy encourage some other approach to the possible loss of plan solvency, such as mandating the establishment of earmarked contingency reserves?

6.4 If a plan sponsor decides to pursue riskier investment strategies to deal with solvency concerns, should this decision be required to be taken according to some special procedures, or made subject to more intensive oversight?

6.5 What effect might changes in the investment strategies of pension plans, and in the rules governing investment strategies, have on capital markets in Ontario?

The Pension Benefits Guarantee Fund

Ontario, like the United States and the United Kingdom — but alone amongst Canadian jurisdictions — maintains a Pension Benefits Guarantee Fund (PBGF), which ensures that a minimum guaranteed level of benefits will be paid to Ontario plan members and pensioners when a plan winds up with insufficient funds and the employer is unable to bring the fund up to full funding. If, in these circumstances, the plan is unable to pay the full benefits promised, the PBGF tops up the payment to the promised benefits or $1,000.00 per month, whichever is less.

The PBGF is funded by premiums paid by employers who maintain defined benefit plans. It has been in place since 1980 without any substantial amendment, despite developments that might affect its operation, such as rising levels of claims against the PBGF; the eroding effects of inflation on the value of top-up payments; the requirement from time to time for additional funding met by loans from the provincial government or special contribution levies; and the exemption of several categories of pension plans from participation.

7.1 Are the present rules concerning premiums, eligibility for protection and levels of protection appropriate? If not, how might these be changed in the longer term?

7.2 Is the PBGF adequate to meet foreseeable claims on it under existing eligibility rules? If not, should the existing rules be changed? Should the PBGF be more appropriately funded?

7.3 Is a guarantee fund, such as the PBGF, the most appropriate way to protect the interests of plan members and pensioners from the effects of plan underfunding or the employer's insolvency? If not, what are the alternatives?

7.4 Should oversight of the PBGF continue to be assigned to Ontario's pension regulator or should it be moved to some other institution? What powers should the overseeing institution have to adjust premiums paid to and benefits paid from the plan?

7.5 What connection should any of the above changes have to rules governing the funding of pension plans?

Significant changes to pension plans as a result of changes in the employment relationship: Wind-ups, splits, mergers and insolvencies

Pension plan members may change jobs, and when they do, the law generally allows them the relatively straightforward option of leaving their pension entitlements in place or taking them with them.

Employers may change too: they may cease operations entirely or in part, become insolvent or simply decide to discontinue their pension plans. Or they may restructure themselves, merge with other companies or sell parts of their operations to other firms that already have, or may establish, their own pension plans. Parallel developments may occur in the public sector as governments reorganize their functions, redistribute responsibilities among various levels and agencies of government and privatize some functions and services. Some of these events may trigger the full or partial wind-up of an existing pension plan. The PBA lays down ground rules governing the winding-up of plans (and the transfer of assets between plans) and establishes procedures for enforcing them. The aim, of course, is to protect the rights of continuing and former employees (whose interests are not necessarily congruent) and of pensioners. And to complicate matters, not only may wind-ups impose substantial costs on the employer, but "the employer" may also turn out to be not the original firm or public agency, but rather a successor to it, its creditors or a trustee in bankruptcy.

A particularly controversial issue has been the effect of wind-ups on plans that are in surplus. Another issue has been the appropriateness of requiring partial wind-ups under rather loosely defined circumstances, especially given that Quebec, for example, makes no provision for partial wind-ups. A third concern has been the effect of wind-up "grow-in" rights that protect the access to early retirement of workers who lose their jobs as a result of the events that triggered the wind-up.

8.1 How should the PBA deal with plan mergers, splits and restructurings? How might such changes affect plan members? How might they affect plan funding?

8.2 Should the same wind-up procedures apply to all kinds of pension plans, or do some require more intensive controls than others? Should wind-up procedures be simplified?

8.3 Should the pension regulator retain discretion within certain parameters to order a wind-up when the viability of the plan is at stake because of corporate restructuring or threatened insolvency?

8.4 Should the PBA be amended to more specifically deal with pension plan mergers?

8.5 Should partial wind-ups in Ontario be eliminated entirely, as they have been in Quebec? If not, should Ontario adopt clearer or different rules concerning the distribution of plan surpluses and the preservation of "grow-in" rights in the event of partial wind-ups?

8.6 What would be the best approach to protecting the ongoing rights of plan members and pensioners, in the event of a material change in the identity, structure or financial circumstances of a sponsoring employer?

Regulating the pension system

Pension plans are established by "sponsors" — usually employers — sometimes in response to contractual arrangements with unions or, occasionally, with employees. As many judicial decisions remind us, they are therefore subject in some respects to the law of trusts and the law of contracts, legal rules of general application that are developed and applied by ordinary courts in all sorts of situations, most of which have little to do with pensions. However, pensions are also subject to the special body of legal rules laid down in the PBA and interpreted and applied by the Superintendent of Financial Services and by an expert tribunal — the Financial Services Tribunal (FST), both agencies of the Financial Services Commission of Ontario (FSCO). Decisions of the Superintendent and the FST are not necessarily final; they may be appealed to the courts.

Further, the Lieutenant Governor in Council (effectively, the provincial cabinet) may make detailed rules and regulations under the PBA which, for example, establish detailed standards for pension plan valuations or define the required levels of "solvency" that plans must maintain. Some provincial standards are derived explicitly or implicitly from norms developed by expert bodies, such as the Canadian Institute of Actuaries, which thereby become, in a practical if not legal sense, the authors of regulatory standards. From time to time, the administration of

Ontario's regulatory regime also becomes entangled with that of the federal government or of other provinces whose residents are the beneficiaries of Ontario-based plans. How these various bodies of law, lawmakers and adjudicators relate to each other is not always clear — even to lawyers, actuaries, regulators and judges. Almost certainly, it is not clear to individual employers who sponsor plans or the employees or pensioners who acquire rights under them.

Finally, the ultimate test of the regulatory system governing pension plans is how well it works in practice. Clarity, predictability, transparency, consistency, practicality and cost efficiency are all important benchmarks by which the system may be judged. These benchmarks require that attention be paid to FSCO's mandate, remedial and regulation-making powers, procedures and staffing levels.

9.1 Should Ontario be seeking to replace or reinforce existing interprovincial arrangements that give it responsibility for pension plans with members outside the province?

9.2 Should an effort be made to clarify and codify the law governing pension plan funding in Ontario? If so, should the PBA be amended to encompass matters now dealt with by the general law?

9.3 Should an effort be made to ensure that pension plan sponsors and beneficiaries are better acquainted with their rights and obligations?

9.4 Are the powers and staff resources of FSCO, the FST and the Superintendent of Financial Services adequate to perform the tasks presently assigned to them, and would the assignment of further responsibilities require additional powers and resources?

9.5 Should some of these tasks be reassigned to other bodies, such as the courts, or discontinued altogether?

9.6 What is an appropriate regulatory role for expert and professional bodies in the Ontario pension system?

Biographies

Commissioner

Harry W. Arthurs

University Professor Emeritus, former Dean of Osgoode Hall Law School (1972–77) and President of York University (1985–92), Harry Arthurs has just completed his assignment as a Commissioner appointed to review Federal Labour Standards legislation.

Prof. Arthurs is a former member of the Economic Council of Canada, former Bencher of the Law Society of Upper Canada, former President of the Canadian Civil Liberties Association and a former Associate of the Canadian Institute for Advanced Research. He is a Fellow of the Royal Society of Canada, a Corresponding Fellow of the British Academy, Canada Council Killam Laureate in the Social Sciences (2002), winner of the Bora Laskin Prize for Contributions to Labour Law (2002) and holder of numerous honorary degrees.

His publications range widely over the areas of labour and administrative law, legal education and the legal profession, globalization and constitutionalism. He has been an arbitrator and mediator in labour disputes, has conducted inquiries and reviews at Canadian and American universities, and has provided advice to governments on a number of issues ranging from higher education policy to the constitution to labour and employment law.

Advisory Panel

Bob Baldwin

Bob Baldwin is an Ottawa-based consultant who specializes in pensions, aging society and labour market issues. He is a Senior Associate with Informetrica Ltd. and an Adjunct Research Professor in the School of Public Policy and Administration at Carleton University.

Mr. Baldwin was Director of Social and Economic Policy at the Canadian Labour Congress from 1995 to 2005 and was the CLC's pension specialist from 1977 to 2005. In that capacity he dealt with the full range of public policy issues with respect to pensions (regulations and tax rules governing workplace pensions; design and role of public pensions). He also bargained pension arrangements and served as a pension plan trustee.

He remains active on pension issues in a consulting capacity. He also serves as a Director of PSP Investments; he is a member of the Committee on Professional Conduct of the Canadian Institute of Actuaries; and he also acts as a pension advisor to the Trade Union Advisory Committee of the OECD.

Kathryn Bush

Kathryn Bush practises in the Pension and Employee Benefits Group in the Toronto office of Blake, Cassels & Graydon LLP and is involved in all aspects of income tax and pension and employee benefits law. In the pension and employee benefits area, Ms. Bush is involved in the pension plan and employee benefit plan creation, drafting, amendment, governance and funding issues as well as dealing with corporate reorganizations and their effect on pension and benefits and providing opinions in relation to all aspects of pension and benefits law. In the income tax area, a substantial portion of her practice is devoted to executive and deferred compensation planning areas, including stock compensation, salary deferral arrangements, retirement compensation arrangements, supplemental pension plans, retiring allowances, profit-sharing plans, cross-border issues and corporate reorganizations.

Ms. Bush is a former Vice-Chair of the Financial Services Commission of Ontario and a former Vice-Chair of the Financial Services Tribunal. She is also a former Vice-Chair of the Pension Commission of Ontario.

She is cited in The Canadian Legal Lexpert Directory as a "leading practitioner" in pension and benefits law and is listed in the Canadian Who's Who.

Ms. Bush has written on a wide range of topics in the areas of income taxation and pension and employee benefits. She is a member of the Canadian Tax Foundation, Canadian Bar Association and Canadian Pension Conference. She has been the co-editor of the Canadian Bar Association Newsletter on Pension and Benefits and has taught for a number of years at the Law Society of Upper Canada's Bar Admissions and continuing legal education courses. In addition, Ms. Bush has chaired and spoken at numerous conferences in Canada.

Murray Gold

Murray Gold practises in pension and employee benefits and related insolvency law. He works in all facets of the pension and benefits sector and has been at the forefront of the advancement of jointly trusteed pension and benefit plans for public sector employees. He has advised in regard to the development and establishment of jointly trusteed public and broader public sector plans in Newfoundland, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia.

He has also been closely involved with the pension insolvencies at both Air Canada and Stelco insolvencies, and advises in regard to corporate governance issues of concern to institutional pension investors. He is Canadian counsel to class plaintiff in the U.S. securities class action Complaint against Nortel Networks.

Mr. Gold is the head of the Pension and Benefits department at Koskie Minsky. He is a member of the expert group constituted by the United Nations Economic

Programme finance initiative in regard to environmental, social and governance (ESG) issues. He is also former Chair of Legal Advisory Committee to the Financial Services Commission of Ontario, and past chair of both the Canadian Pension and Benefits Section of the Canadian Bar Association — Ontario, and the Canadian and Pension Benefits Institute — Ontario Region. He is also a former director of the Employee Stock Ownership Plan Association of Canada.

Currently, he writes a regular legal column for Benefits Canada. Mr. Gold has lectured at the Pension Investment Management School, co-sponsored by the Schulich School of Business, and at the University of Toronto School of Continuing Education for the Certified Employee Benefit Specialist (CEBS) course and has spoken at numerous industry conferences sponsored by the Law Society of Upper Canada, Insight, the Canadian Institute, Infonex and IFEBP. Mr. Gold received an A.B. from Harvard University and an LL.B from the University of Toronto.

Ian Markham

Ian Markham is Director of Pension Innovation, Canada, for Watson Wyatt in Toronto. He specializes in strategic advice in the full spectrum of retirement consulting services, including financing, design, demographic, governance and administration; expertise in conventional and alternative plan designs, as well as with registered retirement savings plans and executive pension arrangements. He has served as an advisor on several committees and think tanks for professional, industry and regulatory issues.

He has 30 years of experience in the actuarial, pensions and benefits fields. He co-ordinates the development in Canada of Watson Wyatt's pension-related innovation, tools and research; serves as lead actuary and client relationship manager for several major clients; is involved in past and current leadership positions within Association of Canadian Pension Management (ACPM), the Retirement Income Coalition, and the Canadian Institute of Actuaries; and has had numerous speaking engagements.

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